FEDERAL RESERVE BANK
OF DALLAS

Dallas, Texas, December 21, 1951

To the Financing Institution Addressed:

There appears below the text of Bulletin No. 2 (revised) of the national Voluntary Credit Restraint Committee, together with a statement issued in conjunction therewith. This material is being sent to all financing institutions at the request of the committee.

Yours very truly,

R. R. GILBERT
President

BULLETIN NUMBER 2 (REVISED) OF THE NATIONAL VOLUNTARY CREDIT RESTRAINT COMMITTEE

RESTRICTIONS OF BUSINESS CAPITAL EXPENDITURES FINANCING

The Voluntary Credit Restraint Committee has reviewed the outlook for business spending on plant and equipment and has revised Bulletin No. 2 as follows:

1. The economic outlook suggests the need for continued careful screening, under the program, of all business capital financing programs. Business spending on plant and equipment is at record levels and is contributing to shortages of basic materials. The prospects are that plant expansion programs will remain at high levels for some time to come; business requirements for outside financing are expected to remain large during 1952. At the same time, the supply situation in several basic raw materials is likely to become worse before it improves. Consequently, financing institutions should exert continued devoted efforts to channel funds used by business concerns into defense, defense-supporting, and essential civilian purposes.

Plant expansion for nondefense and nonessential purposes consumes scarce materials and syphons off funds which might better be used to finance the defense effort. Thus it becomes a menace to the soundness of the American dollar. Such outlays have apparently been large in 1951, although, thanks to careful screening, the amount financed by borrowed money and stock issues has been held to a moderate sum.

However, there will come a time when these nondefense plant expenditures will afford welcome support to business and employment. Business management and finance can jointly do a great public service both now and later by timing plant outlays and the financing thereof with full consideration of the foregoing factors.

2. Typical of the uses of funds which have a high priority under present conditions are the following: Increasing capacity for the production of defense goods and of basic raw materials (such as metals and petroleum); loans to railroads and other public transportation, electric, gas, and water utilities; loans under certain conditions to construction companies with bona fide contracts for the construction of defense facilities, highways, schools, port improvements, public utilities, or railroads.

3. Among the nonessential uses of long-term financing that might be postponed to a more propitious time are those for such purposes as: (1) construction of facilities to improve the competitive position of an individual producer of nonessential goods; (2) expansion and modernization expenditures of concerns in distribution or service lines where the distribution or service is not defense supporting; (3) expansion and modernization programs for the manufacture of consumer goods not related to the defense effort; and (4) purchase of existing plants or firms to improve the diversification of a company's products.

4. The purpose for which funds will be used, rather than the type of financing, is the important consideration in screening capital expenditure financing under the program. Thus, it is recommended that all types of security issues be screened—term loans, notes, debentures, bonds, preferred stock, common stock, sale-lease-back arrangements, or any other form of financing. Interim financing should be screened by the same tests that will be applied to the screening of the ultimate financing.

5. Financing institutions are urged to give equal consideration to the needs of small as well as large business in screening applications for long-term financing.

6. The financing of business plant and equipment programs should be screened under the program even though the project has received a certificate of tax amortization, or has been allotted materials under the Controlled Materials Plan. Such certificates or allotments are important factors which should be given substantial weight by financing institutions and by the regional committees in their screening, under the program, of a financing proposal, but such certificates or allotments should not automatically exempt financing from evaluation under the program. Such screening is welcomed by the Office of Defense Mobilization.

7. Since there may be cases in which business management has decided for policy reasons against applying for a certificate of tax amortization, the absence of such a certificate should not be taken as conclusive evidence that proposed financing of a plant program does not conform to the lending standards of the Voluntary Credit Restraint Program.

TEXT OF STATEMENT ISSUED BY VOLUNTARY CREDIT RESTRAINT COMMITTEE

FINANCING OF BUSINESS CAPITAL EXPENDITURES

High Level of Business Investment—Business spending on plant and equipment is currently at record levels and is likely to remain relatively high for some time to come. In the fourth quarter of 1951, it is estimated that such spending was at the rate of $25 billion per year, and for the year the total is likely to be $23 billion or more. These figures reflect recent Department of Commerce revisions of plant and equipment expenditure estimates, and represent a 15 per cent increase over 1948, the previous record year.

Of the total for 1951, nearly $12 billion will be accounted for by manufacturing and mining, nearly $6 billion by public utilities and transportation, and the remaining $5 billion by trade, service and other. While a substantial part of these expenditures doubtless represents additions to productive facilities that are essential to the defense effort, it seems likewise obvious that a large amount represents expenditures that might better have been postponed until labor and materials were in more plentiful supply. Some decline from the record fourth quarter level would not be unexpected, but present indications are that total expenditures in 1952 may be about as large as for 1951.

Need for Outside Financing—The amount of financing to be done via the securities market, direct placements and the commercial banks may be about as large in 1952 as it was in 1951; the need for outside financing is likely to be especially heavy during the first half of the year. Payments of Federal income and excess profit taxes will be substantially larger in 1952. Furthermore, whereas in 1951 accruals for tax liabilities ran in excess of payments and thus were a source of funds, the reverse may well prove to be the case in 1952. The acceleration of tax payments in the first half of the year as the result of the "Mills Plan" and the probability that corporations in general have not fully provided for their income tax liabilities also mean that the financing requirements of many companies will be unusually heavy in the next few months.

At the same time, retained earnings plus depreciation accruals are expected to show little if any increase from the 1951 level. Thus, corporations may well require a large volume of financing from external sources such as commercial banks, life insurance companies, and the securities markets during 1952.

These prospects suggest the need for an especially careful screening of business financing programs during the next few months. That there is room for restricting nondefense uses of funds is suggested by the data on corporate new capital securities issues, including private placements, during the first nine months of 1951. The aggregate of such financing, $5.3 billion, was significantly larger than in the comparable period in 1950. Of this total, an estimated $3.9 billion was accounted for by such defense and defense-supporting industries as railroads, public utilities, and manufacturers of iron and steel, nonferrous metals, machinery, and other transportation equipment, chemicals, rubber, and petroleum. Of the remaining $1.5 billion, roughly one-half reflected financing by manufacturers of food, beverage, and tobacco products, paper, construction materials, and house furnishings and appliances, and the balance represented issues by trade, financial, and other companies.

Government Policy re Plant Expansion—In part, the current record levels of business spending reflect government policy. Through subsidy and exploration contracts, efforts have been made to increase supplies, largely, of basic raw materials. Of greater aggregate significance is the incentive to plant expansion provided by accelerated amortization for tax purposes. Under this program some 4,300 certificates of tax amortization have been issued covering proposed plant investments amounting to $10.6 billion.

The desire to build at great speed a plant capacity sufficient to meet simultaneously the demands of the defense program and the requirements of a high standard of living civilian economy has meant that it has not been feasible until recently at least, to give much attention to the development of well-integrated programs in the various sectors of our tremendously complex economy. Incentives to plant expansion have not been limited to defense plants, narrowly defined, but have been given to a fairly broad list of industries.

On the other hand, first through N.P.A. certificates and other controls over construction and currently by means of the Controlled Materials Plan efforts have been made to limit less essential construction. But C.M.P. is still in its formative stages. The practice of "over-allotting" has been followed, based on the premise that not all allotments would be utilized, and it has been stated that an allotment is no guarantee that the specified materials will in fact be available. Self-certification allows some use of materials without specific control under the program.

These comments underline the difficult problems encountered in trying to determine, for the expansion of productive plant and for the allotment of short materials, policies appropriate to a part-defense, part-civilian economy. The difficulties are probably greater than they would be under conditions of all-out war. Assistance under the Voluntary Credit Restraint Program will be welcomed by the Office of Defense Mobilization through the process of screening financing for business expansion even though the projects may have received certificates of tax amortization, allotment of materials under C.M.P., or some other similar recognition.

There may be additional reasons for screening the financing of such projects under the program. A certificate of tax amortization does not necessarily mean that financing is required immediately since a considerable period may elapse before the materials will become available. Premature financing increases the probability that funds may be diverted to other uses not related to the project for which a certificate has been obtained. In some cases only part of a plant project may be classified as "essential" whereas the financing program may cover the entire venture. The character and type of financing proposed should be appropriate to the circumstances; thus it would seem reasonable to insist upon reasonably adequate debt retirement provisions in the case of projects which have received certificates of tax amortization. It is conceivable that there may be cases in which financing institutions, because of their intimate knowledge of a local situation, may have reason to doubt whether a given project has a reasonable chance of achieving its objectives.